No. 10,936

In the United States Circuit Court of Appeals for the Ninth Circuit

George S. Gaylord, petitioner

v.

Commissioner of Internal Revenue, respondent

Gertrude H. Gaylord, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 192–222) is reported at 3 T. C. 281.

JURISDICTION

These cases involve federal income taxes for the years 1936, 1937, 1938, and 1939. On September 17, 1941, the Commissioner of Internal Revenue mailed to each of the taxpayers a notice of deficiencies in income taxes for these years. (R. 44–61, 134–151.) The deficiencies asserted against George S. Gaylord totaled

$49,518.76 (R. 46) and the deficiencies asserted against Gertrude H. Gaylord totaled $8,043.63 (R. 136). Within 90 days thereafter and on November 10, 1941, taxpayer George S. Gaylord filed a petition, and on November 26, 1941, Gertrude H. Gaylord filed a petition, with the Tax Court (then the Board of Tax Appeals) for a redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code. (R. 6–96, 101–187.) The decision of the Tax Court finding deficiencies in income tax against Gertrude H. Gaylord for 1936, 1937, and 1939 in a total amount of $8,007.89 was entered July 14, 1944. (R. 273–274.) The decision of the Tax Court finding deficiencies in income tax against George S. Gaylord for 1936, 1937, 1938, and 1939 in a total amount of $47,241.11 was entered August 4, 1944. (R. 274–275.) The cases come to this Court by petitions for review filed by each taxpayer on October 11, 1944 (R. 275–303, 307–334), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTIONS PRESENTED

1. Whether trust income is taxable to the taxpayer-grantors: (a) under Section 166 of the Revenue Acts of 1936 and 1938 and the Internal Revenue Code because the trust was revocable by them under California law; or (b) under Section 22 (a) of the Revenue Acts of 1936 and 1938 and the Internal Revenue Code because they retained such powers over the trust corpus as to remain in substance the owner thereof and of the income; or (c), in the alternative, whether one-half of the trust income for 1936 and the first five months of

1937 is taxable to taxpayers under Section 167 of the Revenue Act of 1936 because that part of the income could under the trust instrument have been used to discharge their legal obligation to support their minor daughter.

2. Whether under the facts the Commissioner is estopped to assert deficiencies in income taxes for 1936–1939, inclusive, against taxpayers.

3. Whether the finding of the Tax Court as to the fair market value of Menasha stock upon acquisition in 1917, which value determines the basis for computing gain on the Marathon stock sold in the taxable years by taxpayers individually and as trustees for the Gaylord trust, is supported by substantial evidence.

STATUTES AND REGULATIONS INVOLVED

These are printed in the Appendix, *infra,* pp. 48–55.

STATEMENT

The Tax Court made findings of fact with respect to the issues on appeal to this Court, the material parts of which may be summarized as follows:

First Issue: Taxability of Trust Income to Grantors

The taxpayers are husband and wife and reside in Pasadena, California. They have two daughters, Margaret, born on November 10, 1905, and Gertrude, born May 31, 1916. Both daughters are married and have children of their own. (R. 195.)

Prior to September, 1935, taxpayers decided to create a trust for the benefit of their two daughters, and in the case of the death of a daughter, then for the benefit of the children of such daughter. On December 11, 1935, the taxpayers signed and acknowledged a declaration of trust in which they were named jointly as trustee. A trust was declared with respect to 7,000 shares of the common capital stock of Marathon Paper Mills Company, 5,000 shares of which were contributed by Mr. Gaylord and 2,000 shares by Mrs. Gaylord. There was no provision relating to whether the trust was revocable or irrevocable.[1] (R. 195–196.)

When requesting counsel to prepare the trust instrument, Gaylord told him that he and Mrs. Gaylord desired to form an irrevocable trust with respect to the stock. At the time the taxpayers signed the trust instrument, they were advised by their counsel that the trust was irrevocable. (R. 196.)

On February 4, 1936, the taxpayers filed gift tax returns, prepared by Gaylord, for the year 1935, in which they reported the creation of an irrevocable trust and the transfer thereto of stock of Marathon Paper Mills Company (hereinafter referred to as Marathon). (R. 196.)

The certificates for the 7,000 shares of Marathon stock were placed in a safe deposit box in California in the name of Mr. and Mrs. Gaylord as trustees. The stock remained there until it was sold. The trustees sold some of the stock in each of the years 1936 through 1939, the last of it being sold in the latter

[1] The trust instrument is printed at R. 61–76. Its provisions will be discussed in more detail, *infra*, in connection with the Government's alternative argument that the trust income is taxable to the taxpayer-grantors under Section 22 (a) of the Revenue Acts of 1936, and 1938, and the Internal Revenue Code.

year.[2] The proceeds of all sales were deposited in an account in a Chicago bank in the names of taxpayers as trustees. (R. 197.)

In connection with the purchase of real estate in Los Angeles County, California, the trustees had the trust instrument recorded in the office of the county recorder of that county on September 23, 1937. In 1938 the trustees purchased $90,000 of real estate situated in Texas and recorded the trust instrument in four counties of that state. (R. 197.)

For each of the years 1936 through 1939, the trustees filed a fiduciary income tax return for the trust, in which each daughter was shown as a trust beneficiary, entitled to one-half of the income thereof. For each of these years the daughters filed income tax returns in which they reported as taxable income received from the trust the amounts shown by the fiduciary returns as having been distributed to them during the respective years. (R. 197–198.)

On March 27, 1940, at the instance of their counsel the taxpayers signed and acknowledged an instrument reading as follows (R. 198–199):

> Declaration Being a Part of a Certain Declaration of Trust Dated November 7, 1935
>
> Know All Men by These Presents:
>
> That Whereas the undersigned, George S. Gaylord and Gertrude H. Gaylord, his wife, of the City of Pasadena, in the County of Los

[2] The proper cost basis for computing gain on the sales of this stock is involved in the second issue. The facts relating to basis are set out, *infra*.

Angeles, State of California, do in and by an instrument of even date herewith entitled Declaration of Trust certify and declare and in and by said instrument have certified and declared that they hold and shall and will hold the following described personal property, to wit: seven thousand (7,000) shares of the common capital stock of Marathon Paper Mills Company, a Wisconsin corporation, of the par value of Twenty-five Dollars ($25.00) per share, and any and all proceeds thereof, In Trust, Nevertheless, for the uses and purposes and upon the terms and conditions set forth in said Declaration of Trust, reference to which Declaration of Trust is hereby made for further particulars thereof: Now, Therefore, said George S. Gaylord and Gertrude H. Gaylord do further certify and declare that the trust created and provided for in said Declaration of Trust was always intended and is intended by said trustors and trustees, George S. Gaylord and Gertrude H. Gaylord, to be and is and shall always be absolutely irrevocable and that this further declaration of said undersigned is and is intended to be and shall always be a part of said Declaration of Trust and is intended to be and shall always be taken with and construed as a part of said Declaration of Trust the same as though this present declaration had been physically incorporated in said Declaration of Trust.

In Witness Whereof, said George S. Gaylord and Gertrude H. Gaylord, said trustors and trustees, have set their hands and seals to this instrument as of this 7th day of November, 1935, at Pasadena, California.

This instrument was left with their counsel and recorded in Los Angeles and Calaveras Counties, California, on March 28, 1940, and May 14, 1940, respectively. (R. 199.)

The Commissioner determined that the net income of the trust for the years 1936–1939, inclusive, was taxable to the taxpayers as grantors under Sections 22 (a), 166, and 167 of the Revenue Acts of 1936, 1938, and the Internal Revenue Code; that since Gaylord had contributed to the trust five-sevenths of the stock, that fractional part of the net income of the trust was taxable to him; and that the remaining two-sevenths of the trust income in these years was taxable to Mrs. Gaylord, since she had contributed two-sevenths of the total corpus of the trust. (R. 46, 137, 199–200.) The Tax Court affirmed this determination, holding that the income was taxable to the grantors under Section 166. (R. 200–206.)

Second Issue: Basis for Computing Gain on Sale of Marathon Stock

In each of the years 1936, 1937, 1938, and 1939, taxpayers individually, and as trustees for the Gaylord trust, sold shares of stock of Marathon Paper Mills Company. (R. 210.) The shares sold by Mrs. Gaylord personally had been acquired by gift from Mr. Gaylord in 1932, and the shares sold by the trustees were those given by them to the trust upon its creation in 1935. The shares contributed to the trust by Mrs. Gaylord had been acquired by her as a gift from Mr. Gaylord in 1930. (R. 211.)

The Marathon stock had been acquired by Mr. Gaylord through the following transactions:

On July 1, 1917, Gaylord owned 337 shares of stock of Menasha Carton Company (hereinafter referred to as "Carton"), which he had acquired at various times prior thereto for a cost of $34,436.50. One Clinedinst also owned 337 shares of Carton stock and all the stock of Menasha Printing Company (hereinafter referred to as "Printing"). (R. 206.)

Clinedinst desired to consolidate the assets and businesses of the two corporations into a new corporation, with Gaylord as its manager. It was agreed that Gaylord should purchase sufficient stock in the new corporation from Clinedinst to bring his holdings therein up to 40% of the total outstanding stock. (R. 206–207.)

The basis for consolidation was left to Gaylord. He determined that the consolidation should be effected on the basis of the appraised value of the physical assets, plus the book value of the quick assets of each of the old corporations. The method of computing the values of the stock of the two old corporations by capitalization of current earnings at ten times such earnings (regarded by Gaylord as a conservative rate) would have indicated a substantially higher value for the stock of the old corporations than was indicated by value of assets. (R. 207.)

The new corporation, Menasha Printing & Carton Company (hereinafter referred to as "Menasha") was formed in 1917 and the consolidation was effected on the basis determined by Gaylord. The value of the Carton assets was determined to be $186,000 and the value of the Printing assets $774,000, making a total of $960,000. For these assets $500,000 in common and $460,000 in preferred stock, both $100 par value per share, of Menasha were issued. On this basis Gaylord was entitled to 449.68+ shares of common and 413.7+ shares of preferred Menasha stock for his 337 shares of Carton stock. Gaylord actually received, however, 410 shares of preferred, par $41,000, and 453.3889 shares of common Menasha stock, par $45,338.89. The fair market value of these shares was $100 per share. (R. 207–208.)

In addition, Gaylord purchased from Clinedinst for a price of $152,161.11 sufficient shares of common stock of Menasha to bring his holdings to 1,975 shares of common. This made his total payment for 1,975 shares the amount of $197,500. In his income tax return for 1917, Gaylord did not report any income on the exchange of 337 shares of Carton stock for stock of Menasha. (R. 208, 209.)

Prior to 1922 all the Menasha preferred stock issued in the 1917 consolidation had been retired. In 1922 or 1923 Gaylord purchased the remaining interest of Clinedinst in Menasha. Prior to October 31, 1927, Gaylord sold some small amounts of Menasha common stock. In 1925 he received a 100% stock dividend on the stock then held. On October 31, 1927, he owned 3,357 shares. (R. 209.)

Of the stock so held on that date 350 shares had been transferred by Gaylord in 1925 to his brother for 432 shares of stock of Robert Gaylord, Inc. The brother subsequently in 1926 or 1927 desired to reacquire the 432 shares of Robert Gaylord stock for use in connection with a reorganization. After negotiation, it was agreed that the 1925 exchange of Menasha stock for Robert Gaylord stock be cancelled, as though it had never existed. Pursuant thereto, the shares were returned to their original owners, each party paying over all dividends which had been received on the respective stocks during the interval. (R. 209–210.)

On October 31, 1927, Menasha was merged with Marathon. In this merger Gaylord received 6,728 shares of Marathon stock and $1,038,000 par value of its 5% bonds in exchange for 3,357 shares of common stock of Menasha. In December, 1929, the Marathon stock was split four shares for one. (R. 210.)

Taxpayers reported gain on the sales of Marathon stock in the taxable years, computed on a basis of $8.21 per share. (R. 211.) The Commissioner determined that the basis per share was $2.83542. (R. 47.) The Tax Court did not approve the basis used by either party but found that the basis of the 3,357 shares of Menasha stock held by Gaylord in 1927 was $50 per share and that computation of the basis of the Marathon shares sold should be computed therefrom.[3] (R. 211–216.)

[3] The computation pursuant to the Tax Court's decision resulted in a basis of $2.84276 each for the Marathon shares sold in the tax years. (See computation of the Commissioner in which taxpayers acquiesced (R. 273, 274) at R. 260–261, 272–273.) In the exchange of Marathon stock and bonds for 3,357 shares of Menasha stock, 46.033% of the $50 value for Menasha stock (pursuant to agreement between the parties) was allocated to the Marathon stock, resulting in a basis per share for Marathon stock in 1927 of $11.37106. This figure was then divided by 4, in order to get the value per share after the 1929 split-up.

SUMMARY OF ARGUMENT

I. Under Section 166 of the Revenue Act of 1936 and subsequent Acts, the income of the trust created by taxpayers for the benefit of their two daughters is taxable to them, because they had a power to revoke the trust. The trust instrument did not provide that it was irrevocable. Consequently taxpayers could have revoked the trust under Section 2280 of the Civil Code of California, which provides that, unless expressly made irrevocable, every voluntary trust shall be revocable. The contention that the trust was not "voluntary" within the meaning of Section 2280 is without merit. The Tax Court found, upon substantial evidence, that the transfer in trust was a gift and not supported by consideration. The intention of taxpayers that the trust should be irrevocable did not make it irrevocable, since Section 2280 requires an express statement in the trust instrument. The mere fact that the trust instrument could have been reformed or amended to state that it was irrevocable does not suffice, since it was neither reformed nor amended in the taxable years. The subsequent amendment in 1940 did not cure the defect in the trust instrument in the earlier years, from which the power to revoke was derived. Statements in the taxpayers' gift tax returns for 1935 that the trust was irrevocable also fail to meet the requirement of Section 2280 that the statement as to irrevocability be contained in the trust instrument.

Since the situs of this trust was in California, the existence of the power to revoke is to be determined under the law of California. Even though some of the trust income was derived from real property situated in Texas, it was income of a revocable California trust.

II. The trust income is also taxable to the grantors under the broad definition of income contained in Section 22 (a) of the Revenue Act of 1936 and subsequent Acts for the reason that their powers of control over the trust were so complete that they were in substance the owners of its income. They possessed, among other powers, the broadest possible powers of management and control over the corpus; the power to vote and otherwise deal with the stock comprising the corpus as an absolute owner; ~~the power to revoke or to retake the corpus by purchasing at a bargain price~~; the power to control the amount of income by selecting investments for the corpus; the power to use some of the income in the years 1936 and 1937 to discharge their legal obligation to support a minor child; and power over the distribution of the corpus. These powers, held in their capacity as trustees, made them virtual owners of the corpus.

III. One-half of the trust income for 1936 and the first five months of 1937 is taxable to the grantors under Section 167 of the Revenue Act of 1936 because there was a possibility that it might be used to discharge the grantors' legal obligation to support their minor daughter.

IV. The Commissioner is not estopped to claim that the taxpayers are subject to tax on the income of the trust. Acceptance of the gift tax returns filed by taxpayers and the income tax returns filed by their daughters does not prevent the Commissioner from collecting the taxes due from the taxpayers, nor does the fact that claims for refund of such gift or other taxes, which may have been paid erroneously, were barred when the Commissioner made his determination in the instant case. Moreover, the Commissioner did not misrepresent any fact, as is necessary to invoke successfully the doctrine of estoppel. Nor was estoppel specially pleaded by the taxpayers, so as to become an issue in the case.

V. The basis for the Marathon shares of stock sold by the taxpayers as individuals and as trustees for the Gaylord trust in the taxable years depends upon the basis of the Menasha shares acquired by Gaylord in 1917 upon consolidation of Carton and Printing into Menasha. Taxpayers do not question the correctness of the Tax Court's holding that the basis of the Menasha shares was their fair market value at the time of acquisition. They contend only that, in finding that the fair market value for the Menasha shares was $100 per share, the Tax Court disregarded the evidence as to earnings of the corporation. The record does not sustain this contention. The Tax Court's opinion shows that it considered all the evidence in reaching its conclusion as to value. Its finding has substantial support in the facts that the value of the assets acquired by Menasha resulted in a value of $100 per share for its stock and that Gaylord purchased shares from Clinedinst at that price at the time of the consolidation in 1917. Since the figures of earnings of Carton, Printing, and Menasha in 1917, testified to by

Gaylord, were not substantiated, since there was no evidence that these earnings were normal so as to justify a valuation by the capitalization of earnings method, based thereon, and since it was not demonstrated that a capitalization of earnings at a 10% rate, as contended by taxpayers, would result in a fair market value for the stock, the Tax Court was warranted in rejecting such evidence of earning capacity as a basis for a finding of the value of the Menasha stock in 1917.

ARGUMENT

I

The trust income is taxable to the grantors under section 166

The Tax Court held that the income of the Gaylord trust was taxable in the years 1936–1939, inclusive, to the taxpayers as grantors under Section 166 of the Revenue Acts of 1936 and 1938 and the Internal Revenue Code (Appendix, *infra*), on the ground that they had the power to revoke the trust under California law in those years. (R. 200–206.) The Government contends that this holding is correct~~, and also, alternatively, that the income of the trust is taxable to the grantors under Section 166 because by using the powers given them by the trust instrument they could have revested title to the trust corpus in themselves~~.

Section 166 provides in part that—

> Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> (1) in the grantor, either alone or * * * then the income of such part of the trust shall

> be included in computing the net income of the grantor.

This provision originated in the Revenue Act of 1924,[4] and certain principles pertinent to this case have been decided with respect to the section.

A grantor has a power to revest title in himself, within the meaning of this section, when he has a power to revoke the trust. *Helvering* v. *Wood*, 309 U. S. 344; *Helvering* v. *Dunning*, 118 F. 2d 341 (C. C. A. 4th), certiorari denied, 314 U. S. 631; *Kraft* v. *Commissioner,* 111 F. 2d 370 (C. C. A. 3d), certiorari denied, 311 U. S. 671. The mere existence of the power to revoke is sufficient to tax the income to the

[4] Section 219 (g) of the Revenue Act of 1924 had a similar provision couched in slightly different language:

"Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

The provision was designed to prevent a common method of evading income tax. H. Rep. 179, 68th Cong., 1st Sess. pp. 6–7, 21 (1939–1 Cum. Bull. (Part 2) 241, 246, 256): S. Rep. No. 398, 68th Cong., 1st Sess., pp. 7, 25 (1939–1 Cum. Bull. (Part 2) 266, 271, 283). Section 166 of the Revenue Act of 1932 amended the provision to provide that the power to revest title must be "vested in the grantor alone or in conjunction with some person not having a substantial adverse interest. Section 166 of the Revenue Act of 1934 and subsequent acts omitted the condition that the power to revest shall exist "during the taxable year." This was to close the loophole through which in *Langley* v. *Commissioner*, 61 F. 2d 796 (C. C. A. 2d) and other cases income was not taxed to the grantor where the provision in the trust instrument was that the grantor had power to revoke only by giving notice of a year and a day. See H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 24 (1939–1 Cum. Bull. (Part 2) 627, 634).

grantor. It is not necessary that the grantor exercise or contemplate exercising the power. Thus, in *Corliss* v. *Bowers,* 281 U. S. 376, the Supreme Court said (p. 378):

> * * *, if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is in the power of the first to appropriate it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

The words of the statute are broad and include any power to revest title in the grantor, without the necessity of inquiring into the source from which that power is derived. It is not limited to cases where the power is derived from the express terms of the trust instrument. *Pulitzer* v. *Commissioner,* 36 B. T. A. 964. Indeed, the existence of a power in the grantor to revoke or revest title in himself is to be determined by the state law. *Helvering* v. *Stuart,* 317 U. S. 154. It follows that when the state law confers upon a grantor a power to revoke a trust, Section 166 requires that the income be taxed to him.[5]

[5] Cf. *Howard* v. *United States,* 125 F. 2d 986 (C. C. A. 5th), in which it was held that the corpus of a previous gift was includible in the gross estate under Section 302 (d) of the Revenue Act of 1926, as amended, because the enjoyment by the donee was subject at the date of death to a change through the exercise of a power vested in the decedent to alter, amend, or revoke the gift. The source of this power in the decedent was a provision of the Civil Code of Louisiana that gifts between married persons during mar-

Section 2280 of the Civil Code of California (1937), as amended in 1931 (Appendix, *infra*), provides in part that:

> Unless expressly made irrevocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee.

The trust instrument in this case contained no statement that it was irrevocable. Accordingly, the Tax Court correctly held (R. 200–206), that the taxpayers had during the years 1936 to 1939, inclusive, a power to revoke vested in them by Section 2280 of the Civil Code and that they were required to include the trust income in their gross income for those years under the express Congressional mandate of Section 166. Taxpayers urge reversal of the Tax Court's holding for seven reasons.

(a) Taxpayers first contend (Br. 26–36) that Section 2280 did not confer upon them a power to revoke the trust, because the trust is not a "voluntary" trust within the meaning of that section, citing as authority *Touli* v. *Santa Cruz County Title Co.*, 20 Cal. App. 2d 495. That case involved an effort by the makers

riage shall always be revocable. The court pointed out that the statute, like the one involved in this case, creates no distinction as to the source of the power to revoke, but applies to any power which is vested in a decedent. See also *Commissioner* v. *Allen*, 108 F. 2d 961 (C. C. A. 3d), certiorari denied, 309 U. S. 680.

Although not expressly decided, it is implicit in the decision of this Court in *Hughes* v. *Commissioner*, 104 F. 2d 144, that a power to revoke existing in the donor of a trust by virtue of Section 2280 of the Civil Code of California would prevent a gift from being a completed gift, subject to gift tax.

to revoke a deed of trust given to secure a note. The court construed Section 2280 of the Civil Code as not applying to trust deeds, which are akin to mortgages, given to secure debts. It said (p. 497) that the word "voluntary" in Section 2280 was used in the "restricted sense of a trust created freely and without a valuable consideration or legal obligation," and not as defined in Section 2216 of the Civil Code (Appendix, *infra*). But cf. *Fernald* v. *Lawsten,* 26 Cal. App. 2d 552, which seems to construe the word "voluntary" in Section 2280 as having the same meaning as in Section 2216, namely, that a voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another.[6] (See p. 559.) And cf. *Hughes* v. *Commissioner,* 104 F. 2d 144 (C. C. A. 9th).

Regardless of which interpretation is given the term "voluntary," the trust in this case was voluntary. It was the free act of the taxpayers, the result of no compulsion whatever. It was made as a gift to the taxpayers' daughters to provide them with financial security. There was no legal or moral obligation to provide for the older daughter who was 30 years old when the trust was created, and although the taxpayers owed the duties of support and education to the younger daughter who was 19 when the trust was created (Sections 25, 196 and 197, Civil Code of Cali-

[6] Section 2215 of the Civil Code (Appendix, *infra*) classifies trusts as either voluntary or involuntary and Section 2217 (Appendix, *infra*) defines an involuntary trust as one created by operation of law.

fornia, Appendix, *infra*), these duties did not oblige them to create a trust for her benefit.

Taxpayers argue (Br. 26–27) that there was consideration for this trust in that each of them agreed to make the declaration of trust in consideration of the agreement of the other to make a contribution to trust corpus. There is, of course, no provision in the trust instrument justifying this argument; it recites no consideration and simply declares that the two taxpayers henceforth hold 7,000 shares of Marathon stock in trust.

The same argument was made to the Tax Court, but it declined to make a finding in taxpayers' favor on this point. It stated in its opinion (R. 201–202):

> There is some argument to the effect that the petitioners by mutual promises became obligated, one with the other, to make gifts to their daughters and that the trust was not therefore a voluntary trust within the meaning of section 2280 as amended. That argument is in our opinion without merit. The purpose and intention of the petitioners was to make gifts to or for the benefit of their two daughters, and a gift, which is the transfer of something to another without compensation, implies and denotes an act of choice, a voluntary act. The creation of the trust was merely the method for effecting or making the intended gift, and it takes its voluntary character therefrom.

Furthermore, the Tax Court denied the taxpayers' motion for reconsideration (R. 223–249) which was based in part on the argument that the mutual agreement of the Gaylords furnished consideration for the trust (R. 224–225).

Thus, the Tax Court has found that the taxpayers intended to make a gift to their daughters and declared a trust as a means of carrying out their intention. Consideration, of course, is opposed to the concept of a gift. This conclusion of the Tax Court is warranted by the record, and was undoubtedly grounded in part on the fact that taxpayers have heretofore taken the position, in their gift tax returns for 1935 (R. 360B–360D, 362B–362C), that the trust was a gift. Their present argument is inconsistent with their view of the nature of the transaction at the time it transpired.

It is true that Mr. Gaylord testified that (R. 340):

> The circumstances which led to the execution of that instrument are as follows: My wife and I agreed together some time previous to September, 1935, that we would form a trust for our children, and if she were willing to give 2,000 shares of the Marthon Paper Mills common stock, of which she was the owner, I would give 5,000 shares of the same stock to form this trust for our children, and in case of their death, for their children forever, * * *.

and Mrs. Gaylord stated that (R. 543):

> Mr. Gaylord and I had made up our minds to give our children some money, both of them, so we had talked it over and we had decided that if I gave 2,000 shares of the Marathon Paper Mills, he would give 5,000, and that was the way it was decided, and you were asked to draw up the trust.

But this testimony shows at most only what the taxpayers decided to do with respect to the trust for their children; it wholly fails to show that each taxpayer made his gift in consideration of the gift of the other, or that one would not have made the gift if the other had not agreed to do so. In any case, assuming *arguendo* that the testimony might be susceptible of the interpretation for which the taxpayers contend, the Tax Court did not so interpret it, but on the contrary, in line with the contemporaneous representation made by taxpayers in their gift tax returns, drew the conclusion that the trust was not supported by consideration. This finding, we submit, is conclusive because supported by substantial evidence, even if the view be taken that the taxpayers' testimony creates a conflict in the evidence as to whether there was consideration for the trust.

The circumstance that Mr. and Mrs. Gaylord might have made an agreement, if such were the fact contrary to the Tax Court's conclusion on the matter, to declare a trust in consideration of a contribution to the trust by the other, would furnish consideration at most for an agreement to declare a trust, and not for the trust itself. The trust represented a gift to the Gaylord daughters and there was clearly no consideration as between the grantors and the beneficiaries of the trust. The "valuable" consideration referred to in the *Touli* case, of course, is a consideration for the trust itself, as between the settlor and the beneficiary, such as is involved where a deed of trust is executed to secure a debt.

The taxpayers' argument (Br. 34) that Section 2280 does not apply to their trust for the reason that they, in the dual capacity of trustors and trustees, could not comply with its terms and file a revocation in writing with the trustee, has no merit; there is no reason why as trustors they could not have revoked and filed the revocation with themselves in their capacity as trustees.

Nor is there merit to the argument that Section 2280 applies only when the trustee is a corporation. (Br. 35.) Not only does the section apply in terms to "every voluntary trust" but it has been construed to permit revocation of a trust where an individual was the trustee. See *Fernald* v. *Lawsten, supra.*

(b) Taxpayers argue (Br. 36–46) that, even if their trust was a voluntary trust, their oral intention that the trust was to be irrevocable had the effect of supplying the scrivener's omission of a provision that it was irrevocable.

This suggestion, of course, is contrary to the provisions of Section 2280 of the Civil Code that unless *expressly* made irrevocable *by the instrument creating the trust,* every voluntary trust shall be revocable. Hence, the mere intent on the part of the grantors to make the trust irrevocable is not sufficient under Section 2280; that section dictates that the trust instrument itself must so provide. See *Hughes* v. *Commissioner, supra,* wherein a donor created a trust but did not provide that it should be irrevocable. Although it was held that the question of revocability was to be determined by the law of Massachusetts rather than that of California, this Court rejected a contention of the taxpayer that the trust was irrevocable in California, despite Section 2280 of the Civil Code, because the donor intended it to be irrevocable and so expressed his intention in an affidavit.

The provisions of the Civil Code of California (Sections 1640, 3399, and 3401 (Pet. Br. 37-38)), providing for the disregard of, and reformation or revision of a "contract" if it fails through mistake to express the intentions of the parties, have no application to a declaration of trust, which is not a "contract." The California courts have recognized that Section 3399 applies to contracts founded on consideration and not to "voluntary" deeds. *Enos* v. *Stewart*, 138 Cal. 112; *Robertson* v. *Melville*, 60 Cal. App. 354.[7] The grounds suggested by taxpayers for distinguishing the *Enos* case are predicated on the assumption that the declaration of trust in this case is founded on a valuable consideration. It has been shown above that this assumption is not justified.

It may be that equity, apart from any provision of California law, would have reformed the declaration of trust to express the intention of the taxpayers that the trust be irrevocable, but this is beside the point. The declaration of trust was not reformed or revised during any of the tax years here involved. On the contrary, the original declaration remained in full force and effect throughout the period. Moreover, it seems pointless to discuss reformation, since the tax-

[7] The cases relied on by taxpayers (Br. 38-40) are not in point since they deal only with true contracts.

payers had a much simpler remedy; they at any earlier time, as they did in 1940, could have amended the instrument to make it irrevocable.

Consequently, taxpayers up to the date of the execution of the second and supplemental instrument on March 27, 1940, could have revoked the trust. If anyone had questioned their right to do so, all that was necessary to uphold the right to revoke was to point to the California law and the absence in the trust instrument of a declaration of irrevocability. This power to revoke, even though not exercised, means that the trust income is taxable to them under the plain terms of Section 166 of the appropriate Revenue Acts.

(C) Taxpayers contend (Br. 46–51) that their affirmative answers in their 1935 gift tax returns to the question whether they had transferred property during the year without consideration by the creation of an irrevocable trust for the benefit of another (R. 360B, 362B) amended or modified the declaration of trust to make it irrevocable. The obvious answer to this contention is that the gift tax returns do not purport to be, nor were they intended as an addition to, or an amendment of, the trust instrument; they were simply a report to the Government, required by law, of transfers by way of gift made by them in 1935. Section 2280 of the Civil Code is specific that a trust is revocable unless expressly made irrevocable by the instrument creating the trust. Consequently, any provision as to irrevocability, to be effective, must be found in the trust instrument itself, and not some document which is not a part of the trust agreement. *Hughes* v. *Commissioner, supra*, p. 147.[8]

(d) The contention (Br. 51–53) that the amendment to the trust instrument made in 1940 (R. 76–80) relates back to 1935, making the trust irrevocable from that date, also is without merit. Even if it be assumed *arguendo* that for some purposes the amendment might be treated as effective from the date of the creation of the trust, the issue here is whether in each of the tax years involved—1936, 1937, 1938, and 1939—this trust was revocable; and under California law, it was revocable in those years because the instrument creating the trust did not state in those years that it was irrevocable. Nothing the grantors did after 1939 can change the fact that they had the power to revoke the trust instrument in the earlier years. Cf. *Jurs* v. *Commissioner* (C. C. A. 9th), decided February 12, 1945, not yet reported, which involved an unsuccessful effort to change the legal effect of a waiver in certain years by a subsequently executed writing.

The circumstances (e) that the Gaylord trust would have been irrevocable in other states (Br. 53–54) and

[8] The case of *Union Trust Co. of Pittsburgh* v. *McCaughn*, 24 F. 2d 459 (E. D. Pa.) (cited Pet. Br. 50), does not hold that recitals in a gift tax return will be construed as amending a trust instrument. In that case a testator had endeavored to create a trust with respect to an insurance policy but this failed because no beneficiaries were named. Subsequently in his will the testator named a beneficiary of half the proceeds of the policy. It was held that this perfected the trust with respect to one-half the proceeds. That case simply involved a trust which was contained in two documents, neither of which was complete in itself. In the instant case, the declaration of trust in the taxable years is found complete in one document, the trust instrument.

(f) that many of the transactions of the trust have been had in other states (Br. 55–58) do not alter the conclusion that this trust was revocable in California, which is the controlling law.

In *Hughes* v. *Commissioner,* 104 F. 2d 144, this Court considered a trust instrument, executed by a resident of California in California, transferring securities to a trust company in Massachusetts as trustee. The instrument contained no provision that it was irrevocable. The question was whether the donor had made a taxable gift; if the trust was revocable, there was not a completed gift. The Court applied Massachusetts law to determine whether the trust was irrevocable on the ground that Massachusetts was the seat of the trust.

The Court there cited with approval 2 Beale, the Conflict of Laws (1935), Sections 297.1 and 297.2, wherein the rules are stated that the seat or situs of a trust determines all questions relating to its administration, including the question whether the settlor may revoke; and further that the seat of a trust is determined by the intention of the settlor. Where private persons are appointed trustees, their domicile may determine the trust situs, but other circumstances, such as the domicile of the settlor and beneficiaries, the location of the trust property, the place where the deed of trust was executed, and its language may be considered. And once determined, the seat of the trust is not altered by removal of the trust res to another jurisdiction. See also as supporting these rules Land, Trusts in the Conflict of Laws (1940), Sections 37–38; Restatement of the Law, Conflict of

Laws, Sections 297, 299; *Noble v. Rogan*, 49 F. Supp. 370 (S. D. Calif.).[9]

In the instant case the situs of the trust was plainly in California. The trust instrument was executed there, the domicile of the trustees, settlors, and beneficiaries was in this state (see R. 355, 508, 524, 527) and California was also the place where the certificates of stock, the trust res, were located until sold and where the trust was administered (R. 355). The trust instrument discloses no intention on the part of the grantors that the situs of the trust shall be in any state other than California.[10]

[9] Cf. *Forbes v. Commissioner*, 82 F. 2d 204 (C. C. A. 1st), holding that the law of Massachusetts, where a trust was created and administered, and in which the trust property was located, controlled the question of whether estates in trust following life estates were vested or contingent; *Commissioner v. Kellogg*, 119 F. 2d 54 (C. C. A. 3d), applying New Jersey law to determine the same question, because the trust was created in New Jersey; and *Hutchinson v. Hutchinson*, 48 Cal. App. 2d 12, in which the court held that Illinois law governed application of the parol evidence rule to a written trust where the declaration of trust was made in Illinois by citizens of Illinois, and so far as was shown the trust obligations were to be performed there. See also Annotations, 139 A. L. R. 1129 and 89 A. L. R. 1023.

[10] Taxpayers make reference (Br. 53–54) to the fact that Northern Trust Company of Chicago, a foreign corporation, was designated in the trust instrument. But it was designated as successor trustee only if both the grantors failed to exercise their powers to appoint successor trustees. (R. 73–74.) As a matter of fact, on December 1, 1941, George S. Gaylord exercised his power and named his older daughter and the husband of his younger daughter, both of whom were residents of California, as successor trustees. (R. 489–492.) On December 2, 1941, taxpayers resigned as trustees. (R. 494–497.) In any case, the mere mention of a trust company which might possibly become a trustee in the future is not sufficient to overbalance all the other elements which locate the trust in California.

It is true, of course, that after the creation of the trust, the trustee sold the stock transferred to the trust in 1935 and with some of the proceeds purchased real estate in Texas and California. However, the subsequent acquisition of land in Texas does not alter the situs for administration of the trust fixed initially, and the applicability of California law thereto. 2 Beale, Section 297.1, p. 1024; *Matter of Bradford,* 165 Misc. (N. Y.) 736; *Marsh* v. *Marsh's Executors,* 73 N. J. Eq. 99. See also Land, Trusts in the Conflict of Laws (1940), Sections 38, 40.2. The rents received on land in Texas (Pet. Br. 68–69), therefore, were income of a revocable California trust.

(g) The Tax Court found that there was no evidence of an oral irrevocable trust in this case (R. 204), contrary to taxpayers' argument that there was such a trust (Br. 58–60). The evidence is that taxpayers decided to create an irrevocable trust and that they subsequently executed a written declaration of trust to carry out this intent. It is an elementary principle that where there is a written instrument, all previous oral agreements merge into it and no longer subsist. In any event, the trust income with which this case is concerned is not the income of an oral trust, but on the contrary is income from the properties belonging to the trust created by the writing executed in 1935; all the income arises from the shares of stock comprising the initial corpus, or from the property into which the initial corpus was converted.

Taxpayers' suggestion (Br. 59) that parol evidence is admissible to explain their intention is not valid.

While parol evidence perhaps might be admissible if there were some ambiguity in the trust instrument, there is no ambiguity here requiring explanation. Cf *Hutchinson* v. *Hutchinson*, 48 Cal. App. 2d 12, 20. This case is concerned only with the entire omission in the trust instrument of the express statement as to irrevocability, required by state law.

Accordingly, it is submitted that all of the trust income is taxable to the grantors under Section 166 in the proportions determined by the Commissioner and approved by the Tax Court.[11]

II

Alternatively, the income is taxable to the grantors under section 22 (a)

Under the broad definition of income contained in Section 22 (a) of the Revenue Acts of 1936, 1938, and the Internal Revenue Code (Appendix, *infra*), income of a trust may be attributable as income of the grantor thereof where he retains such control over the trust property that he remains in substance the owner thereof. *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Stuart*, 317 U. S. 154. This is but an application of the principle that the owner of property may not assign or dispose of his right to receive the income therefrom in a way to avoid income tax thereon. *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v.

[11] It is not questioned by taxpayers that *Gaylord* is taxable on five-sevenths of the income and Mrs. Gaylord on two-sevenths thereof. This division is manifestly correct for that was the proportion in which they contributed corpus. Cf. *Colonial Trust Co.* v. *Commissioner*, 111 F. 2d 740 (C. C. A. 2d).

Eubank, 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579.

Although the Commissioner relied upon Section 22 (a) as well as Section 166, and Section 167 in the case of Mr. Gaylord, in the deficiency letters (R. 46, 137), the Tax Court, in view of its decision that Section 166 applies, made no finding as to whether Section 22 (a) also applied.[12] The Government contends, however, that the decisions of the Tax Court may be supported on the ground that the grantors in this case retained such powers of control over the trust property that they were in substance the owners thereof. This question appears to be primarily one for the trier of the facts, and if the Court should disagree with the Government's position that the trust income is taxable to the grantors under Section 166, it is suggested that under the practice followed by the Supreme Court in *Helvering* v. *Stuart,* 317 U. S. 154, the case should be remanded to the Tax Court for a finding on this point.

In the *Clifford* case the grantor was held taxable under Section 22 (a) upon trust income paid to his wife as beneficiary, where the trust was to continue for a short term of five years or until prior death of the taxpayer or his wife; and upon termination of the

[12] The applicability of Section 22 (a) is a question which the Government may argue before this Court, particularly when the Commissioner relied on the section in the deficiency letters. See *Helvering* v. *Stuart*, 317 U. S. 154; *Hormel* v. *Helvering*, 312 U. S. 552. Furthermore, a respondent on review may urge any matter appearing in the record in support of the judgment below. *Helvering* v. *Gowran*, 302 U. S. 238; *LeTulle* v. *Scofield*, 308 U. S. 415, rehearing denied, 309 U. S. 694; *Ryerson* v. *United States*, 312 U. S. 405.

trust the corpus was to go to the grantor or his estate but any undistributed income was the property of the wife. The grantor was the sole trustee with broad powers of control over the trust property. The reason for the decision was that since the grantor retained so many controls over the investment and kept the income within the family group, there was no substantial change in his economic position. "For as a result of the terms of the trust and the intimacy of the familial relationship respondent retained the substance of full enjoyment of all the rights which previously he had in the property." (p. 335.) The Court said further (p. 334):

> Technical considerations, niceties of the law of trusts or conveyances, or the legal paraphernalia which inventive genius may construct as a refuge from surtaxes should not obscure the basic issue. That issue is whether the grantor after the trust has been established may still be treated, under this statutory scheme, as the owner of the corpus. See *Blair* v. *Commissioner,* 300 U. S. 5, 12. In absence of more precise standards or guides supplied by statute or appropriate regulations, the answer to that question must depend on an analysis of the terms of the trust and all the circumstances attendant on its creation and operation. And where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as § 22 (a) is concerned.

The principle of the *Clifford* case has not been restricted to its precise facts. In *Helvering* v. *Stuart,* 317 U. S. 154, the trust was a long term trust, and neither principal nor income was to return to the grantor. Nevertheless the grantor's control over the trust corpus was great and the Court said (p. 168):

> * * * economic gain for the taxable year, as distinguished from the non-material satisfactions, may be obtained through a control of a trust so complete that it must be said the taxpayer is the owner of its income.

Although this Court has apparently not had occasion to pass on the scope of Section 22 (a) in connection with trust income, the cases applying the rule of *Helvering* v. *Clifford* in other fact situations are legion. See, e. g., *Stockstrom* v. *Commissioner* (C. C. A. 8th), decided March 24, 1945 (1945 P–H, par. 72,465); *Miller* v. *Commissioner* (C. C. A. 6th), decided February 13, 1945 (1945 P–H, par. 72,376); *Commissioner* v. *Buck,* 120 F. 2d 775 (C. C. A. 2d); *White* v. *Higgins,* 116 F. 2d 312 (C. C. A. 1st); *Losh* v. *Commissioner,* 145 F. 2d 456 (C. C. A. 10th); *Williamson* v. *Commissioner,* 132 F. 2d 489 (C. C. A. 7th); *Whitely* v. *Commissioner,* 120 F. 2d 782 (C. C. A. 3d), certiorari denied, 314 U. S. 657.

In the instant case the following facts, most of which have been singled out as significant in other cases in determining whether the grantor retained substantial ownership, lead to the conclusion that the grantors remained owners of the trust corpus in the taxable years.

The trust was a family trust, and the income was retained in the family group.[13] The grantors had substantial other income in each year, in excess of their normal needs, so far as the record shows. (R. 48–61, 138–148.) Thus, the relinquishment of the right to receive income of the trust did not mean much economically and may well be balanced by other rights of control which they retained. Cf. *Stockstrom* v. *Commissioner, supra; Commissioner* v. *Buck*, 120 F. 2d 775 (C. C. A. 2d); *George* v. *Commissioner*, 143 F. 2d 837 (C. C. A. 8th).

The grantors named themselves trustees, and retained the power to name successor trustees. (R. 73–74.)

As trustees they retained powers of management and control over the trust corpus as though they were absolute owners. They could hold securities in their own names. They could invest and reinvest the corpus, lend it, sell it, exchange, lease, or mortgage, all at prices and upon such terms as they deemed advisable. (R. 62–66.) Their discretion was absolute and uncontrolled, and its exercise conclusive on all persons.[14]

[13] Children of the settlor are members of the intimate family group, even though they are adults and married. *Commissioner* v. *Wilson*, 125 F. 2d 307, 310 (C. C. A. 7th); and see *Commissioner* v. *Berolzheimer*, 116 F. 2d 628 (C. C. A. 2d).

[14] In view of their absolute discretion, the exercise of which was conclusive on the beneficiaries, the power of the grantor-trustees was for practical purposes independent of the control of a court of equity. See Section 2269, Civil Code of California (Appendix, *infra*); *Cox* v. *Commissioner*, 110 F. 2d 934 (C. C. A. 10th), certiorari denied, 311 U. S. 667; *Rollins* v. *Helvering*, 92 F. 2d 390 (C. C. A. 8th), certiorari denied, 302 U. S. 763. In *White* v. *Higgins*, 116 F. 2d 312 (C. C. A. 1st) the trustee, who was also

(R. 65.) In *Central Nat. Bank* v. *Commissioner,* 141 F. 2d 352 (C. C. A. 6th), the power to direct the investment and reinvestment of the trust funds was the pivotal factor on which, with respect to one of the trusts, application of the *Clifford* doctrine turned. See also *Whitely* v. *Commissioner, supra.*

They could vote the stocks forming the corpus of the trust and otherwise deal with them as an absolute owner. (R. 65.) This is a very valuable right of ownership, particularly since the grantors owned individually shares in the same company and Mr. Gaylord was connected with the management of the corporation. The retention of voting rights enables the grantor more effectively to impose his will on the corporation and may be a more substantial economic benefit to him th~~e~~an the right to receive income on the shares. See *Helvering* v. *Stuart, supra,* p. 169; *Miller* v. *Commissioner, supra; Stockstrom* v. *Commissioner, supra; Bush* v. *Commissioner,* 133 F. 2d 1005 (C. C.

grantor of a trust of an insurance policy, had the power at any time to demand the cash surrender value of the policy, and if she deemed it advisable for her own comfort, maintenance, or welfare, to pay the whole or any part of the corpus over to herself individually. The court said (p. 320):

"Granting that these are fiduciary powers, so were the powers of control over investment which the court regarded as significant in the *Clifford* case. With such a vague criterion of judgment prescribed in the trust instrument, it is highly improbable that anyone could successfully invoke the power of a court of equity to upset a decision by Mrs. Higgins as trustee to terminate the trust by assignment of the trust property to herself individually. It is equally improbable that anyone of the "intimate family group" would ever attempt to do so."

And see *Stockstrom* v. *Commissioner* (C. C. A. 8th), decided March 23, 1945 (1945 P-H, par. 72, 465).

A. 2d); *Williamson* v. *Commissioner, supra; McKnight* v. *Commissioner*, 123 F. 2d 240 (C. C. A. 8th).

They had the whole title to the property, legal and equitable, the beneficiaries having only the right to enforce the performance of the trust. (R. 66.)

They had the power under California law to revoke the trust, and thus retake the corpus. Cf. *White* v. *Higgins, supra.*

Although the income was distributable annually to the beneficiaries (R. 67), the trustees could control the amount of income to be distributed. They could reduce, or even cut off, all income by exercising their powers to sell the corpus, and reinvesting in non-income-producing property; or by leasing the real property, acquired later, for little or no consideration; or by using their broad powers in other ways. Furthermore, the trust contained spendthrift provisions (R. 70); the beneficiaries therefore had no rights of ownership in or control over trust income until it was actually distributed.

One-half of the income could have been used in the years 1936 and until her marriage in 1937 to discharge the grantors' obligation, under Sections 196 and 197 of the Civil Code, to support their younger daughter (R. 68) who was not of age when the trust was created (Section 25, Civil Code of California).[15] This power

[15] Although Section 134 of the Revenue Act of 1943 (Appendix, *infra*) amended Section 167 of the Internal Revenue Code to provide that the mere possibility that trust income may be used to discharge a legal obligation of support of the grantor is not enough to tax it to the grantor, the amendment was not intended to remove this fact from consideration as one of the indicia of ownership that would make Section 22 (a) applicable. S. Rep. No. 627, 78th Cong., 1st Sess., pp. 68–69.

would have enabled them to use the income directly for their own economic benefit. Cf. *Douglas* v. *Willcuts,* 296 U. S. 1.

Upon termination of the trust,[16] all of the trust estate then existing was to vest in the two principal beneficiaries (or their issue) share and share alike. (R. 69–70.) But in making distributions the trustees had the sole judgment and discretion to make divisions and allotments and to determine the relative values of the property, their acts to be conclusive on all interested persons. (R. 71.) By this control over valuation and distribution, the trustees could in effect vary the shares of the beneficiaries and indeed could distribute substantially the whole corpus to one beneficiary of their choosing. The retention of this power to control the ultimate distribution of the trust fund is, we submit, an important attribute of ownership.

Upon termination of the trust, there was a possibility that the trust corpus would revert to Mrs. Gaylord. (R. 69–70.) She as grantor therefore retained a remote interest in the corpus, and this fact is to be considered under Section 22 (a). See *Miller* v. *Commissioner* (C. C. A. 6th), decided February 13, 1945 (1945–P–H, par. 72,376).

The fact that the taxpayers may not necessarily become repossessed of the corpus and the income does not militate against the conclusion that they have the powers of an owner. It is sufficient that they control the family purse strings. *Stockstrom* v. *Commis-*

[16] The maximum duration of this trust was for a period of about 10½ years, but it could terminate earlier. (See R. 68.)

sioner, supra; George v. *Commissioner*, 143 F. 2d 837 (C. C. A. 8th); *Warren* v. *Commissioner, supra;* and cf. *Helvering* v. *Stuart*, *supra.* Nor is the fact material that the powers are reserved as trustee rather than as grantor, when trustee and grantor are the same. In the *Clifford* case the donor's powers of control were reserved to himself as trustee and this has been true in other cases also. *Foerderer* v. *Commissioner*, 141 F. 2d 53 (C. C. A. 3d); *Stockstrom* v. *Commissioner, supra; Miller* v. *Commissioner, supra.* And see Article 166–1 of Treasury Regulations 94 and 101, and Section 19.166–1 of Treasury Regulations 103 (Appendix, *infra*).

No one fact is decisive of the question, but when all the powers and controls which the grantors retained over the corpus and income are added together, their "bundle of rights" requires, we submit, that the trust income be taxed to them under Section 22 (a).

III

Section 167 also applies

Section 167 (a) (2) of the Revenue Act of 1936 (Appendix, *infra*) provides for taxing such part of the trust income to the grantor thereof as may in the discretion of the grantor, or some person not having a substantial adverse interest, be distributed to the grantor. While this language refers in terms only to distributions that may be made directly to the grantor, the Supreme Court in *Helvering* v. *Stuart*, 317 U. S. 154, 170, has construed it to cover income as to which there is a possibility that it may be distributed in discharge of the grantor's legal obligation to support his minor children. In the instant case, one of the beneficiaries, entitled to receive half of the income, was a minor when the trust was created in 1935. She did not become 21 until May 31, 1937, but was married on May 29, 1937 (R. 195), at which time she was an adult. Section 25, Civil Code of California. Throughout 1936 and until May 29 in 1937, therefore, the grantors owed a duty to support her. Sections 196 and 197, Civil Code of California. Article IV of the trust instrument gives the trustees discretion to apply any part of the trust income to the use and for the proper care, maintenance, support, and education of the beneficiaries. (R. 68.) The possibility that one-half of the trust income for 1936 and the first five months of 1937 might be used to discharge the parental obligation is sufficient, under the *Stuart* case, to attribute income to this extent to the grantors under Section 167 (a) (2).

Section 134 of the Revenue Act of 1943 (Appendix, *infra*) amended Section 167 of the Internal Revenue Code by adding a new subsection (c) providing that income of a trust shall not be considered as taxable to the grantor merely because it may be used to discharge his legal obligation of support, but shall be taxed to him only to the extent that it is so used. The provision has retroactive effect to all prior years, but only if signed consents, as prescribed by the Commissioner, are filed that there shall be paid all taxes which would have been payable if subsection (c) had been a part of the law in earlier years.

The amendment made by Section 134, if applied to this case, would render inappropriate the Government's argument that Section 167 (a) (2) applies. No consents as required by the amendment have, however, been filed up to the present time. Consequently, the argument that Section 167 (a) (2) applies is presented, subject to possible withdrawal, if consents are filed.

IV

There is no estoppel against the Commissioner

The Commissioner is not estopped to contend that the trust income is taxable to the grantors in the years 1936–1939, inclusive, merely because he accepted, without adjustment, the gift tax returns for 1935 filed by the grantors and the income tax returns filed by the two beneficiaries for the years 1936–1939 in which they included the trust income. (Pet. Br. 61–67.) *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357; *Mt. Vernon Trust Co.* v. *Commissioner*, 75 F. 2d 938 (C. C. A. 2d), certiorari denied, 296 U. S. 587. And even if acceptance of the returns could be construed as an assent that the returns correctly interpreted the tax effect of the trust instrument, which we do not concede, the Commissioner is not estopped to change his determination as to the legal effect of a given transaction. *Burnet* v. *Porter*, 283 U. S. 230; *Tonningsen* v. *Commissioner*, 61 F. 2d 199 (C. C. A. 9th); *Knapp-Monarch Co.* v. *Commissioner*, 139 F. 2d 863 (C. C. A. 8th).

The mere fact that claims for refund of the gift taxes and the income taxes paid by the daughters were barred when the deficiency letters were mailed to taxpayers has no bearing.[17] In *Van Antwerp* v. *United States,* 92 F. 2d 871, this Court declined to hold the taxpayer estopped to claim a refund, even though the Government was barred by the statute of limitations, when the claim was filed, from assessing and collecting taxes due from his wife. See also *Helvering* v. *Brooklyn City R. Co.,* 72 F. 2d 274 (C. C. A. 2d).

Furthermore, to constitute estoppel there must be a misrepresentation of a fact or a wrongful misleading silence with respect to a fact. *Van Antwerp* v. *United States, supra,* p. 875; *United States* v. *S. F. Scott & Sons,* 69 F. 2d 728, 732 (C. C. A. 1st). A person knowing the facts or in a position to know them can not claim the benefit of estoppel. *Hull* v. *Commissioner,* 87 F. 2d 260 (C. C. A. 4th).

In this case the Commissioner has not misrepresented a fact or held his silence with respect to any fact. Moreover, since the taxpayers knew all the facts and were in a position to know their legal effect equally as was the Commissioner, there is no ground for estoppel against the Commissioner. The Tax Court's holding that, since estoppel had not been specifically pleaded, it was not an issue in the case (R. 205), is correct and is a further ground for rejecting the taxpayers' claim of estoppel. See *Tide Water Oil Co.* v. *Commissioner,* 29 B. T. A. 1208; *El Dorado Oil Works*

[17] It may be noted that taxpayers were apparently on notice as to what the Commissioner's position was likely to be at least by the end of 1940. A report of an examination was submitted, dated December 21, 1940, and protests were filed, and several conferences held prior to the issuance of the deficiency letters. (R. 46, 136.)

v. *Commissioner*, 46 B. T. A. 994. Cf. *Helvering* v. *Brooklyn City R. Co.*, 72 F. 2d (C. C. A. 2d).

V

There is substantial evidence to support the Tax Court's findings of basis of the Menasha stock

The last question raised by taxpayers (Br. 69–80) relates to the basis for computing profit upon sales of Marathon stock made by taxpayers individually and by the Gaylord trust in the taxable years. The Marathon stock sold by the trust and Gertrude H. Gaylord was all acquired by gift from Gaylord and has the basis it would have in his hands under Section 113 (a) (2) of the Revenue Acts of 1936, 1938, and the Internal Revenue Code. Consequently, a determination of his basis decides the question for all the parties.

Gaylord acquired all the Marathon stock,[18] plus bonds, in exchange for 3,357 shares of Menasha stock in 1927, in a non-taxable transaction on which gain or loss was not recognized under Section 203 (b) (2) of the Revenue Act of 1926, c. 27, 44 Stat. 9. The Marathon stock and bonds therefore under Section 204 (a) (6) of the Revenue Act of 1926 took the basis of the 3,357 Menasha shares for which they were exchanged. There is no dispute as to the manner of allocating the basis of the Menasha shares between the Marathon stock and bonds. (R. 212.)

The 3,357 shares of Menasha stock owned on October 31, 1927, were traced by the Tax Court as the remain-

[18] One hundred shares sold in 1939 by Gaylord individually were acquired by him in 1933 for $1,700. There is no dispute as to the basis for these shares. (R. 211.)

ing portion of the 1,975 shares of Menasha common stock acquired by Gaylord upon organization of Menasha in 1917, plus the 100% stock dividend thereon in 1925. (R. 212.)

The answer to the basis question, therefore, depends on the basis to Gaylord of the 1,975 Menasha common shares acquired in 1917, together with preferred shares, in exchange for 337 shares of Carton stock and $152,161.11 in cash. The law in 1917 contained no provision for non-recognition of gain or loss upon reorganization exchanges, or for a carry-over of basis.[19] The Tax Court therefore held (R. 214) that Gaylord, in 1917, realized gain or sustained loss upon the exchange equal to the difference between the fair market value of the Menasha shares acquired and his cost or other basis for his Carton stock. It held further that the basis for the Menasha shares was the basis of the Carton shares surrendered, increased by the gain realized or decreased by the loss sustained on the exchange; or in other words, the basis for the Menasha shares was the same as their fair market value when acquired. It found this value to be $100 per share. (R. 208, 215.)

Taxpayers agree that the correct basis for the Menasha shares is their fair market value when acquired in 1917. (Br. 75.) They contest only the Tax Court's finding of fair market value. (See Br. 75–76.)

[19] Section 2 (a) of the Revenue Act of 1916, c. 463, 39 Stat. 756, referred to by taxpayers (Br. 71, 72), contains merely the broad general definition of income. It says nothing about the basis for property, or cost thereof.

We submit that the Tax Court's finding of value is supported by substantial evidence and hence is conclusive in this Court. *Elmhurst Cemetery Co. v. Commissioner,* 300 U. S. 37.

Upon acquisition of the assets of Carton and Printing in 1917, Menasha issued its stock in an amount equal to the appraised value of the physical assets and the book value of the quick assets so acquired. It was reasonable for the Tax Court to accept these values as representing the value of the Menasha stock. This was the value which Clinedinst and Gaylord placed on the assets and stock at the time of the transaction and the value on which they based the consolidation. Gaylord specified that the consolidation would be effected on the basis of appraised value of physical assets and book value of quick assets, but certainly if Clinedinst had thought the appraised and book values very far out of line from the fair market values of the assets, he would not have traded on that basis. His interest in the enterprise was more than ten times that of Gaylord. (R. 207.)

The values of the assets behind a stock are an important factor in fixing its value. But here the assumption is warranted that the physical assets were appraised at their fair market value, since that would be the usual basis for appraisal; in any case, there is no evidence that they were not so appraised, and in fact the taxpayers stated in Exhibit G, attached to their petitions, that this value was the "actual value." (R. 93.) As to the quick assets, there is nothing to show that their fair market value was greater than their book value, and in the usual case, quick assets, or liquid assets such as cash, notes, bonds, and other items readily convertible into cash, are carried on the books at their true value. Hence, in the absence of evidence to the contrary,[20] the Tax Court was justified in accepting these values as representing fair market values.

Of the 1,975 shares of Menasha common stock acquired by Gaylord in 1917, only 453.39 were acquired in exchange for his old stock. The remaining 1,521.61 shares were acquired from Clinedinst for a price of $152,161.11, or $100 per share. Whether this purchase be regarded as a separate transaction or only a step in the consolidation (Pet. Br. 76), the price fixed between the two parties as the sale price for the stock is additional evidence supporting the Tax Court's finding of value.

Taxpayers contend that the Tax Court acted arbitrarily in disregarding the evidence as to the earning power of the assets. But the Tax Court's opinion, on the contrary, shows that it did consider such evidence as there was regarding earning power. It discussed the evidence and stated that it had considered all the evidence in reaching its conclusion as to value. (R. 215.) An examination of the evidence as to earnings shows that it was not substantial enough to base a finding of value thereon.

[20] Taxpayers' contention is not that the assets were undervalued, but that the Menasha stock should be valued on the basis of earning power alone.

Gaylord testified (R. 367–368) as to the earnings in round figures of the three companies for the year 1917, and stated that if they had used "ten for one" earning capacity to value the Menasha stock, they would have had a value per share of $600 (R. 370). This testimony is not supported by any evidence that a 10% rate of capitalizing earnings is reasonable or proper, except Gaylord's statement that it might be called "conservative" (R. 369), or that such a rate would result in a fair market value for the stock. Nor is there any evidence to show how the figures of earnings testified to by the witness were computed, or that they in fact represented true earnings of the three companies. Even if they did represent the real earnings, it is a well known fact, as the Tax Court pointed out (R. 215) that corporate earnings during the war years were abnormally high in most cases and without some proof that such earnings were normal, they would not afford a proper foundation on which to value stock by the capitalization of earnings method.

The only other evidence in the record relating to capitalization of earnings is that in Exhibit G, attached to the petition. (R. 92–96.) There figures purporting to represent earnings of the three companies for the years 1915–1919, inclusive, are set out (R. 94), but again there is no proof as to the correctness of the figures or how they were arrived at. It is also stated in Exhibit G that "Taxpayer believes that the 1917 earnings of the Carton Company capitalized at ten per cent reflect correctly the fair market value of the stock of that company * * *." (R. 94.) But there is no supporting data to show on what the belief is based.

In this state of the record, there was no evidence on which the Tax Court could have made a finding of fair market value by the capitalization of earnings method, had it felt that method was proper under the facts of this case. Consequently, the Tax Court did not act arbitrarily in not basing its finding of 1917 value on this evidence.

Taxpayers apparently contend (Br. 80) that the 352 shares of Menasha stock, exchanged in 1925 for Robert Gaylord stock and then reacquired in 1927 in exchange for the same Gaylord stock, as though the first exchange had never existed, carry a different basis. We submit that the effect of the two exchanges was to cancel out the transaction entirely, as the parties intended, and that the 352 shares retain their original basis. This appears to have been the view of the Tax Court also. However, if the two exchanges are to be singled out and given separate effect, contrary to the Tax Court's treatment of the matter (cf. *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231), taxpayers must fail in any event since there is no evidence as to the fair market value of, or the basis for, the 352 shares in 1927. Although taxpayers refer to a fair market value for 352 shares set out in a computation attached to their petitions (R. 96, 186), this figure is not substantiated in any way.

CONCLUSION

The decisions of the Tax Court should be affirmed.

Respectfully submitted,

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April, 1945.

APPENDIX

Civil Code of California (1937):

SEC. 25. *Minors, who are: Construction of section: Married female deemed adult.*—Minors are all persons under twenty-one years of age; provided, that this section shall be subject to the provisions of the titles of this code on marriage and shall not be construed as repealing or limiting the provisions of section 204 of this code; provided, further, that any female who has contracted a lawful marriage and is of the age of eighteen or over, shall be deemed to be of the age of majority and to be an adult person for the purpose of entering into any engagement or transaction respecting property or her estate, or for the purpose of entering into any contract, the same as if she was twenty-one years of age. [Enacted 1872; Amended by Stats. 1927, p. 1119; Stats. 1931, p. 1941.]

SEC. 196. *Obligation of parents for the support and education of their children.*—The parent entitled to the custody of a child must give him support and education suitable to his circumstances. If the support and education which the father of a legitimate child is able to give are inadequate, the mother must assist him to the extent of her ability. [Enacted 1872.]

SEC. 197. *Custody of legitimate child.*—The father and mother of a legitimate unmarried minor child are equally entitled to its custody, services and earnings. If either the father or mother be dead or unable or refuse to take the custody or has abandoned his or her family, the other is entitled to its custody, services and earnings. [Enacted 1872; Amended by Code Amdts. 1873–74, p. 194; Stats. 1913, p. 52.]

SEC. 2215. *Trusts classified.*—A trust is either:

1. Voluntary; or,

2. Involuntary. [Enacted 1872.]

SEC. 2216. *Voluntary trust, what.*—A voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another. [Enacted 1872.]

SEC. 2217. *Involuntary trust, what.*—An involuntary trust is one which is created by operation of law. [Enacted 1872.]

SEC. 2269. *Discretionary powers.*—A discretionary power conferred upon a trustee is presumed not to be left to his arbitrary discretion, but may be controlled by the proper court if not reasonably exercised, unless an absolute discretion is clearly conferred by the declaration of trust. [Enacted 1872.]

SEC. 2280. *Revocation of trusts.*—Unless expressly made irrevocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee. When a voluntary trust is revoked by the trustor, the trustee shall transfer to the trustor its full title to the trust estate. Trusts created prior to the date when this act shall become a law shall not be affected hereby. [Enacted 1872; Amended by Stats. 1931, p. 1955.]

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *.

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom.

then the income of such part of the trust shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction):

> then such part of the income of the trust shall be included in computing the net income of the grantor.
>
> (b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question".

Sections 22 (a) and 166 of the Revenue Act of 1938, c. 289, 52 Stat. 447, and the Internal Revenue Code are the same as the above quoted sections.

Revenue Act of 1943, Public Law 235, 78th Cong., 2d Sess:

> SEC. 134. TRUSTS FOR MAINTENANCE OR SUPPORT OF CERTAIN BENEFICIARIES.
>
> (a) *Income for Benefit of Grantor.*—Section 167 (relating to income for benefit of grantor) is amended by adding at the end thereof the following subsection:
>
> "(c) Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor."

(b) *Taxable Years to Which Applicable.*—

(1) *General rule.*—Except as provided in paragraph (2), the amendments made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1942, unless a taxable year of the trust beginning in 1942 ends within a taxable year of the grantor beginning in 1943, in which case, except as provided in paragraph (2), such amendments shall not be applicable to such taxable year of the grantor.

(2) *Retroactive effect.*—The amendments made by subsection (a) shall also be applicable with respect to all taxable years to which such amendments are not made applicable under paragraph (1), in the same manner as if such amendments had been a part of the revenue laws applicable to such taxable years, but only if there are filed with the Commissioner (in accordance with regulations prescribed by him with the approval of the Secretary) at such time and by such persons as may be prescribed under such regulations, signed consents that there shall be paid, at such time as the Commissioner may prescribe, all of the taxes under Chapter 1 of the Internal Revenue Code or under the corresponding provisions of prior revenue laws which would have been paid for the taxable years concerned if such amendments had been a part of the revenue laws applicable to such taxable years.

(3) *Deficiencies and overpayments.*—The period of limitations provided in sections 275 and 276 of the Internal Revenue Code or corresponding provisions of a prior revenue law on making of assessments and the beginning of distraint or a proceeding in court for collection shall with respect to any deficiency resulting from any such consents include one year immediately after the date such consents were filed, and such assessment and collection may be made notwithstanding any provision of the

> internal revenue laws or any rule of law which would otherwise prevent such assessment and collection. The period within which claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, with respect to any overpayment by the grantor resulting from the consents shall include one year immediately after the date of the filing of the consents, and credit or refund may be allowed or made notwithstanding any provision or rule of law (other than this subsection, section 3760 of the Internal Revenue Code or a corresponding provision of prior law, relating to closing agreements and section 3761 of the Internal Revenue Code or a corresponding provision of prior law, relating to compromises) which would otherwise prevent such credit or refund. No interest shall be allowed or paid on any overpayment, or assessed on any deficiency, resulting from the application of paragraph (2) of this subsection.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> Art. 166–1. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.
>
> (*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest

the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend, or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and

> definitely with the substantial incidents of ownership in the corpus.
>
> In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: The fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarly and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.
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> * * * * *

Article 166–1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Section 19.166–1 of Treasury Regulations 103, promulgated under the Internal Revenue Code, are substantially the same as the above quoted article.

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